ONE HUNDRED TWELFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6143

MAJORITY (202) 225–5074
FACSIMILE (202) 225–3974
MINORITY (202) 225–5051

http://oversight.house.gov

May 1, 2012

Mr. Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20551

Dear Acting Director DeMarco:

For more than five months since you testified before the Oversight Committee, we have been trying to obtain documents and data that you promised to provide explaining why the Federal Housing Finance Agency (FHFA) has refused to allow principal reductions for borrowers with mortgages backed by Fannie Mae and Freddie Mac.

During your testimony on November 16, 2011, you insisted that you had personally examined information from both enterprises and concluded that allowing principal reductions would not be in the best interests of taxpayers. You stated:

> We have been through the analytics of the underwater borrowers at Fannie and Freddie, and looked at the foreclosure alternative programs that are available, and we have concluded that the use of principal reduction within the context of a loan modification is not going to be the least-cost approach for the taxpayer.

Contrary to your testimony, we have now obtained a wide range of internal documents demonstrating that Fannie Mae officials conducted detailed, substantive analyses and concluded years ago that principal reduction programs have enormous potential to save U.S. taxpayers significant amounts of money by reducing overall losses from foreclosures following default. Although we recently obtained some of these documents directly from you in response to our request last November, we obtained from an independent source several additional documents that are labeled "confidential," "proprietary," and "internal," and that you apparently have been withholding from Congress.

Together, these documents reveal how Fannie Mae officials worked with Citibank beginning in 2009 to develop a "shared equity" principal reduction pilot program that ultimately was terminated for unspecified reasons. The documents show that Fannie Mae officials strongly supported the concept of principal reduction and fully evaluated its risks and benefits as they obtained the necessary internal approvals to finalize the program. For example:

- A November 2009 presentation to Fannie Mae's Risk Subcommittee stated that "[t]he business case for shared equity is strong" and that "underwater borrowers will perform better on a modification that reestablishes equity." It also stated that re-default rates on portfolios containing loans that receive principal reductions "are far below rates on other modification portfolios."

- A December 2009 Business Case for Fannie Mae's shared equity principal reduction pilot program concluded that "more than half of Fannie Mae customers will see some benefit from the project. ... Benefits will be realized within six months … there are high negative impacts to not implementing. ... Project will have some positive impact on the industry." Fannie Mae officials estimated that implementing the pilot program would cost about $1.7 million, while the benefits could total more than $410 million.

- In April 2010, a risk management official wrote an e-mail to Fannie Mae's Single Family Risk Officer stating, "We have reviewed the terms and conditions of the pilot program and recommend that you approve the pilot. … The Pilot Team is looking to implement in June and need final stakeholder sign off. ... This will be your last official approval as the Risk Officer for the Credit Portfolio." The Risk Officer responded: "I approve."

- When the program was suddenly suspended in July 2010, Citibank officials asked what changed at the "11th hour." No document has been produced that memorializes this decision or its justification. Subsequent e-mails among Fannie Mae employees assert that Fannie Mae could not "operationally support the shared equity piece," but no documents have been produced that compare the costs of addressing these "operational" challenges to the significant benefits Fannie Mae estimated the program would yield. Instead, a former Fannie Mae employee has informed us that the program was terminated by officials who were "philosophically opposed to writing down principal balances."

- In November 2010, after the pilot was terminated, Fannie Mae officials continued to press internally for principal reductions. A detailed 30-page research paper concluded that "Fannie Mae might reduce its losses substantially in many cases by writing down principal." The paper also concluded that Fannie Mae losses resulting from foreclosures following default were "large multiples of the amounts by which the loans were underwater."

Despite the clear conclusion reached by Fannie Mae officials that principal reduction would reduce losses to the taxpayer, this pilot program was prevented from ever getting off the ground. It remains unclear why you failed to mention this in your testimony and why you failed to disclose this principal reduction program to the Committee. In order to obtain a complete and accurate understanding of the decisions regarding principal reduction, this letter sets forth our concerns in detail, requests documents relating to your responses to Congress, and seeks interviews with key Fannie Mae officials involved in these matters.

New Documents Confirm that Principal Reductions Could Have Saved Taxpayers Significant Amounts of Money

The documents we have obtained confirm that Fannie Mae officials concluded several years ago, after substantial study and review, that principal reduction programs could save Fannie Mae and U.S. taxpayers significant amounts of money by reducing overall losses from foreclosures following default, even when compared to alternatives such as principal forbearance.

Presentation to Fannie Mae's Risk Subcommittee

Based on the documents, it appears that the Risk Subcommittee of Fannie Mae's Executive Committee held a meeting on November 10, 2009, during which it approved continued development of a pilot program for principal reduction modifications with Citibank as its private sector partner.

One of these documents is an "Executive Committee Risk Subcommittee Agenda" dated November 10, 2009.[1] Attached to this agenda was a November 5, 2009, PowerPoint presentation entitled, "Shared Equity for Loss Mitigation Update." The "key findings" presented to the Subcommittee were:

> ***The business case for shared equity is strong***
> - Growing evidence of importance of equity to post-modification performance
> - Proposed shared equity product fills a significant gap in loss mitigation "toolkit"
> - Initial NPV analysis indicates meaningful benefit
>
> ***No "show stoppers" appear to prevent development of a solution in Q2 2010***
> ***CitiMortgage expresses strong support for this initiative***
> - Recent management decision to pursue pilot development
> - Stated desire to accelerate development/implementation timeline
>
> ***Shared equity concept gaining exposure as new home financing tool***[2]

The document cited specific data demonstrating that "underwater borrowers will perform better on a modification that reestablishes equity" and that re-default rates on portfolios containing loans that receive principal reductions "are far below rates on other modification portfolios." The document also stated: "Little effort needed to accommodate principal forgiveness."

In explaining the rationale for the program, the document stated: "Preventing borrowers from 'walking away' will minimize losses—keeping people in their homes typically less expensive than costs of foreclosure." It continued: "Targeted principal reductions with shared

---

[1] Fannie Mae, *Executive Committee Risk Subcommittee Agenda* (Nov. 10, 2009)

[2] Fannie Mae, *Shared Equity for Loss Mitigation Update* (Nov. 5, 2009) (emphasis in original).

equity potentially can address walk-away behavior. … Shared equity component should minimize moral hazard risk."

The document also explained that while the foreclosure option "[c]auses continued degradation to community/market, further pressuring the investor and its counterparties' risk profiles," the shared equity option "[a]voids destabilizing effect of foreclosure."

Based on this data, Fannie Mae's Risk Subcommittee and the senior management of its National Servicing Organization (NSO) reviewed and approved this principal reduction program, according to several additional PowerPoint presentations in December 2009.[3]

Fannie Mae's Business Case for Principal Reduction

The documents you produced indicate that on December 24, 2009, Fannie Mae officials proceeded with the principal reduction program by submitting for internal review a detailed "business case" with estimates of the financial benefits that would result from the program, as well as the justification for going forward. It stated:

> The primary goal of the technique is to re-establish economic interest in the home for the occupying homeowner without creating undue moral hazard, resulting in the occupying homeowner having both the capacity and willingness to make ongoing investment in the home. Additionally, the technique seeks to align interests between the occupying homeowner and equity investor and, if possible, to establish a "comparable" in the market at a value that is expected to be greater than what would be set based on a distressed short or foreclosure sale to a third party.[4]

The document also stated:

> [M]ore than half of Fannie Mae customers will see some benefit from the project. ... Benefits will be realized within six months and/or there are high negative impacts to not implementing. ... Project will have some positive impact on the industry. ... NPV is positive AND payback period is between 12 and 24 months.

The document also stated:

> Fannie Mae systems and operations are equipped to modify a loan using principal forgiveness. All impact will be associated with ability to acquire, track and account 2nd lien equity interest. Additionally it is assumed that Fannie Mae will

---

[3] *See, e.g.*, Fannie Mae, *Shared Equity for Loss Mitigation Product Committee Meeting* (Dec. 3, 2009); Fannie Mae, *Shared Equity for Loss Mitigation Local Governance Committee Meeting* (Dec. 16, 2009).

[4] Fannie Mae, *Business Case Form – Shared Equity for Loss Mitigation* (submitted Dec. 24, 2009).

be able to accommodate this transaction from a variety of legal perspectives (tax, charter, MI, etc.).

Finally, the document estimated that the expected costs of implementing this program would be approximately $1.7 million, while the estimated benefits would be more than $410 million.

Final Testing, Development, and Approval

Additional documents demonstrate that, over the next six months, Fannie Mae officials completed key milestones and obtained the necessary approvals to proceed with the program. For example, a PowerPoint presentation issued on February 12, 2010, reported:

> ***Largely finalized product structure and pilot design***
> ***Developed legal approach to address nearly all Fannie Mae issues***
> ***Completed CLM LGC and EGC process for funding planning and design***
> ***Drafted ERM approval memo for product/pilot terms and conditions***
> ***Received bids from prospective marketing and communications vendors***[5]

According to this document, Fannie Mae officials briefed FHFA officials in detail on the project, including providing a "deep dive" scheduled for February 2010.

On April 15, 2010, more than 50 officials from Fannie Mae and Citibank met to conduct a half-day "end-to-end process walk through" in order to finalize timelines for the program, identify outstanding issues, and review the program's integrated test plan. Officials participated from more than a dozen different Fannie Mae offices, including Capital Markets Pricing, Financial Systems, Single Family Risk, Internal Audit, Credit Valuation, and others.[6]

Finally, on April 28, 2010, Fannie Mae officials submitted to the Risk Officer for Fannie Mae's Credit Portfolio their formal risk recommendation to approve the principal reduction program, writing in an e-mail:

> **We have reviewed the terms and conditions of the pilot program and recommend that you approve the pilot. The attached recommendation has details of the risk analysis and mitigants. We also will work with [Fannie Mae official] to ensure that there is appropriate ongoing report out to the governance body that she will be creating. The Pilot Team is looking to implement in June and need final stakeholder sign off. We have attached the term sheet and our formal risk recommendation. Please let me know if you have any questions. We committed to**

---

[5] *See, e.g.,* Fannie Mae, *Shared Equity for Loss Mitigation Update* (Feb. 12, 2010) (emphasis in original).

[6] Fannie Mae, *Shared Equity End-to-End Process Walk Through* (Apr. 15, 2010).

> **the Pilot Team that we would strive to have you [sic] approval by COB Friday. This will be your last official approval as the Risk Officer for the Credit Portfolio.**[7]

In response, the Risk Officer sent an e-mail that Friday stating: "I approve."[8]

New Documents Provide No Justification for Sudden Reversal

Despite months of detailed preparation and development at both Fannie Mae and Citibank, and despite obtaining the necessary internal approvals to proceed, the principal reduction program was suddenly suspended in July 2010, and later terminated, according to the documents.

As we explained in our letter to you on February 8, 2012, a former Fannie Mae employee has informed us that the program was terminated by officials who were "philosophically opposed to writing down principal balances."[9] Unfortunately, none of the documents you produced memorialize the decision to terminate the program or the justification for this decision. Instead, a series of e-mails describes how Fannie Mae officials informed Citibank that the program had been suspended, but they provide little detail about why.

For example, on July 22, 2010, an official in Fannie Mae's National Servicing Organization (NSO) sent an e-mail to the Fannie Mae employee charged with communicating the news to Citibank that the principal reduction program was being suspended. The e-mail stated: "We realize that this is a difficult message to give to Citi at this stage. NSO leadership stands ready to assist you with the message in any way that you think will help."[10]

Four days later, on July 26, 2010, a senior director in Fannie Mae's Servicing Portfolio Management division sent an internal e-mail to colleagues confirming that Fannie Mae officials had decided to suspend the program until 2011. The e-mail stated: "The NSO has determined that we won't be able to operationally support the shared equity piece of this until 2011."[11]

---

[7] E-mail from Fannie Mae Vice President for Risk Management to Fannie Mae Single Family Risk Officer (Apr. 28, 2010) (emphasis in original).

[8] E-mail from Fannie Mae Single Family Risk Officer to Fannie Mae Vice President for Risk Management (Apr. 28, 2010).

[9] Letter from Ranking Member Elijah E. Cummings and Committee Member John F. Tierney to Edward DeMarco, Acting Director, Federal Housing Finance Administration (Feb. 8, 2012) (online at http://democrats.oversight.house.gov/index.php?option=com_content&task=view&id=5614&Itemid=104).

[10] E-mail from Fannie Mae National Servicing Organization Vice-President to Fannie Mae Senior Vice President of Single Family Business (July 22, 2010).

[11] E-mail from Fannie Mae National Servicing Organization Director of Product Development to Fannie Mae Vice President of Marketing (July 26, 2010).

Three days later, on July 29, 2010, a Fannie Mae official explained in an internal e-mail that Citibank was surprised by the sudden news that Fannie Mae was suspending the program. The e-mail stated:

> I spoke to [a Citibank official] this afternoon about our final decision on the Shared Value pilot. As [he] wanted to understand what changed at the "11th hour", I took him through a great deal of detail about our decisions and the reasons for the technology delay. He was clearly disappointed to hear the Q2 2011 date but accepted it as is.[12]

Subsequent e-mails indicate that Citibank remained interested in pursuing the principal reduction program. For example, an e-mail sent on August 10, 2010, between Fannie Mae officials stated that Citibank "indicated they will wait for us to proceed with them on the pilot in 2011" and that they "remain very interested in doing the pilot."[13]

Despite Citibank's ongoing interest, the program was not implemented in 2011 or at any time thereafter. There is no discussion in the documents about the specific operational concerns that led to the decision to suspend, and ultimately cancel, the program. The documents also include no estimates of how much it would have cost to address any operational issues associated with implementing the program. The documents indicate that the program's Business Case was approved at least five times in 2010, and that the costs of implementing the program were estimated to be $1.7 million while its benefits were estimated to be more than $410 million. Obviously, understanding any additional operational costs would have been an important factor to compare against the substantial benefits that Fannie Mae officials estimated would have resulted from the program.

Internal Documents Withheld from Congress Show
Fannie Mae Could "Reduce Its Losses Substantially"

In addition to the documents you have produced, we have now obtained through an independent source copies of several other documents marked "Fannie Mae Proprietary and Confidential" and "Confidential—Internal Distribution" that were not included in your production. It is unclear why you failed to provide these documents in response to our request. To the best of our knowledge, none of these additional documents has been provided to Congress previously.

---

[12] E-mail from Fannie Mae Senior Vice President of Single Family Business to Fannie Mae National Servicing Organization Director of Product Development, Fannie Mae Vice President of Marketing, Fannie Mae Senior Director of Portfolio Management, et al (July 29, 2010).

[13] E-mail from Fannie Mae National Servicing Organization Director of Product Development to Fannie Mae Senior Vice President, National Servicing Organization, et al. (Aug. 10, 2010).

These documents also confirm that Fannie Mae officials concluded that principal reductions had the potential to save the taxpayer significant amounts of money. Further, they indicate that even after the program was suspended in July 2010, Fannie Mae officials continued to believe that principal reduction would substantially reduce the total amount of losses that Fannie Mae would incur from defaults and foreclosures.

One of the documents we have obtained is a detailed 30-page "Overview of Research Findings" entitled "Delinquent Mortgage Borrower Types and Potential Implications for Loss Mitigation." It appears that this document was circulated among Fannie Mae officials in November 2010. One of its most significant conclusions was that "Fannie Mae might reduce its losses substantially in many cases by writing down principal."

The research overview also concluded that Fannie Mae's net financial losses resulting from certain segments of defaulting borrowers are "large multiples of the amounts by which the loans were underwater, and the aggregate magnitude by which these losses exceed the borrowers' negative equity amounts is substantial." The analysis also found that the "actual losses" from liquidation of these underwater loans "are more severe—by approximately 18%—than expected losses."

Conclusion

Based on the documents we have obtained, it appears that the shared equity principal reduction pilot program should have been implemented years ago, and the failure to do so may have resulted in unnecessary losses to U.S. taxpayers. This was not merely a missed opportunity, but a conscious choice that appears to have been based on ideology rather than Fannie Mae's own data and analyses.

The documents make clear that Fannie Mae officials concluded as far back as 2009 that principal reduction programs had enormous potential to save the U.S. taxpayers significant sums of money, even when compared to other types of modifications, such as forbearance. Fannie Mae's own analyses found that implementing just the limited pilot program with Citibank could have saved more than $410 million while costing only $1.7 million to implement. Since the program was terminated, however, Fannie Mae was unable to refine the program and broaden its application to larger populations.

As we stated in our letter to you on February 8, 2012, a former Fannie Mae employee has informed us that the principal reduction pilot program could have been the model for a much larger program that would have saved taxpayers even more. He stated: "I believe that we could be saving tens of billions of dollars while also helping stabilize housing prices and stimulating economic growth."

Based on the information above, we have very serious concerns about your public statements, your previous responses to us, and your failure to provide Congress with complete and accurate information about these important matters. As a result, we request that you:

(1) produce no later than May 11, 2012, all documents requested in our two previous letters on November 30, 2011, and February 8, 2012, that have not yet been provided;

(2) produce no later than May 11, 2012, all documents and communications relating to the preparation and drafting of the letters and information you provided to us on January 20, 2012, and April 12, 2012, including all previous drafts, edits, comments, suggestions, and e-mail communications relating to these responses proposed or provided by yourself, FHFA employees, Fannie Mae employees, or others; and

(3) make available for staff interviews, no later than May 18, 2012, the Fannie Mae officials listed in Attachment A whose names appear in the documents you produced.

Please have your staff contact Davida Walsh at (202) 225-5051 to arrange for the production of these documents and to schedule these interviews.

Sincerely,

Elijah E. Cummings
Ranking Member

John F. Tierney
Member

cc: The Honorable Darrell E. Issa, Chairman
Committee on Oversight and Government Reform